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FEDERAL COMMUNICATIONS COMMISSION
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Before the
FEDERAL COMMUNICATIONS COMMISSION
Washington, D.C. 20554

In the Matter of	
Revisions to Cable Television Rate Regulations	MB Docket No. 02-144
Implementation of Sections of The Cable Television Consumer Protection and Competition Act of 1992: Rate Regulation	MM Docket No. 92-266
Implementation of Sections of The Cable Television Consumer Protection and Competition Act of 1992: Rate Regulation	MM Docket No. 93-215
Adoption of a Uniform Accounting System for the Provision of Regulated Cable Service	CS Docket No. 94-28
Cable Pricing Flexibility	CS Docket No. 96-157

COMMENTS OF
THE NATIONAL ASSOCIATION OF TELECOMMUNICATIONS OFFICERS AND ADVISORS, THE NATIONAL LEAGUE OF CITIES, AND THE MIAMI VALLEY CABLE COUNCIL

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November 4, 2002

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SUMMARY

The Commission's current rate rules do not work. The rules are difficult and expensive to enforce, and even where they are enforced, they do not have the effect Congress directed the Commission to achieve: holding rates to reasonable levels for consumers. These Comments focus on certain selected areas in which the rules could be improved. Principal recommendations include:

- Reaffirm that cable operators must comply with local rate orders unless and until those orders are stayed or reversed. (II.B.1)
- Establish straightforward fines or forfeitures for enforcement. (II.B.2)
- Allow actual competitive rates to be used as a standard for setting nearby non-competitive rates. (II.B.3)
- Proactively investigate and sanction evasions of the rate rules. (II.B.4)
- Proactively investigate anticompetitive practices by cable operators. (II.B.5)
- Provide for funding for implementation of the Commission's rules by local communities. (II.B.6)
- Require that a demonstration of effective competition show that all subscribers in the area to be declared competitive actually have competitive alternatives; that the programming offered is in fact comparable in content to the basic cable tier; and that the operator has verified the necessary data. (III.B)
- Decline to find effective competition based solely on DBS. (III.B)

- Require effective competition petitions to be submitted to the local franchising authority, which will submit them to the Commission with its comments. (III.B)
- Clarify that, programming costs aside, moving a channel out of (or into) the basic tier means moving that channel'spro *rata* share of the residual. (IV.B)
- Require that an operator that is found to have misapplied the Commission's rules must go back and correct that error in every rate filing containing that error. (IV.B)
- Review aggregate equipment filings at the Commission level, or through a third-party accountant directed by the Commission with input from local franchising authorities. (V.B)
- Clearly reject sampling techniques used by cable operators in place of true aggregate data, or else specify the proper methodology for such sampling. (V.B)
- Make explicit rules to prohibit practices by incumbents that stifle competition, covering single-family residential subscribers as well as MDUs. (VI.B)
- Clarify that operators must charge the same rates to commercial as to residential subscribers, unless and until the Commission adopts separate regulated rates for commercial subscribers consistent with the statute. (VII.B)
- Permit any subscriber who has been discriminated against on "commercial rate" grounds to file a complaint directly with the Commission for relief, or alternatively with the local franchising authority. (VII.B)

The above recommendations are designed to address the following problems discussed in these Comments.

In General. The statute requires the Commission to protect subscribers by ensuring that basic rates are reasonable, *i.e.*, equivalent to what *would* be charged if there were real competition. The Commission is to work with local communities as co-regulators and must make rules to prevent evasions by cable operators. Yet cable rates remain unreasonable. They are not constrained to reasonable levels by alleged competition from DBS.

The Commission's rules do not fulfill the intent of Congress. In many cases they actually yield a maximum permitted rate *higher than the monopoly rate,* which proves that the rules are not generating reasonable (that is, competitive) rates. The rules have developed loopholes and defects over time. They are unnecessarily time-consuming and expensive for local communities to apply. The Commission has failed *to* prevent evasions; in fact, some of its past decisions actually encourage and reward evasions.

Effective Competition. The Commission's rules allow effective competition to be declared where it does not really exist. This occurs when two operators divide an overlapping franchise area between them. It also occurs when the Commission accepts without investigation unverified data on DBS "competition," to which local communities do not have access, despite the Commission's finding that the presence of DBS alone does not necessarily produce reasonable rates. Finally, the Commission has at times accepted possible future competition as if it were the real thing.

Channel Movement. Cable operators have sought to take advantage of alleged ambiguities in the Commission's rules to continue charging basic subscribers for channels even after those channels have been removed from the basic tier. The Commission's June, 2002 ruling appeared to resolve this issue, but was amended in such a way as to perpetuate confusion and possibly to permit evasion. The Commission should not allow cable operators' errors in applying the rules to stand, even if such errors may have been made in good faith.

Aggregated Equipment Rates. The 1996 Act allowed cable operators to use aggregate costs to arrive at equipment rates, rather than costs specific to the franchise area. But the Commission's implementation allowed operators to aggregate in such a way as to impede review by local franchising authorities. In some cases this has resulted in significantly higher rates for equipment under the aggregation rules. The Commission did not decisively enforce its rules to prevent the use of "sampling" techniques instead of aggregation or to ensure that operators supplied the data necessary to allow local communities to verify their rates.

Uniform Rates. The Commission has applied the statutory requirement for uniform rates only on a franchise area basis. This allows cable operators to charge supracompetitive rates in monopoly areas while reducing rates where there is real competition. The Commission can, however, determine effective competition and apply its rate rules in those areas where subscribers lack a choice of cable providers, even if such an area is only part of a franchise area, and thus move toward effecting the purposes of Congress.

Commercial Rates. The statute directs the Commission to protect "subscribers" from unreasonable rates, without distinguishing between residential and commercial subscribers. Thus the Commission's rules make no provision for separate, higher rates for "commercial" subscribers. But the Commission's inaction on this issue has allowed cable operators to discriminate among subscribers based on whether the operator considers a given subscriber's use "commercial."

If the Commission does not enforce sound rate rules, rates *will* be unreasonable. Thus the statutory mandate means that the Commission must take affirmative steps to stop evasions and to make sure its rules work as they should. The Commission may not, consistent with its legal obligations, permit its rules to be misused or abused.

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The National Association of Telecommunications Officers and Advisors; the National League of Cities; and the Miami Valley Cable Council (regulating rates for the cities **of** Centerville, Germantown, Kettering, Miamisburg, Moraine, Oakwood, Springboro and West Carrollton) (collectively, the Local Government Coalition) hereby submit the following comments in response to the Commission's above-captioned Notice of Proposed Rulemaking and Order, FCC 02-177, released June 19, 2002 ("*NPRM&O*").[1]

I. INTRODUCTION

A. Rate Regulation Is Necessary to Protect Consumers.

Rate regulation is an unfortunate necessity, like visiting the dentist. As the statutory provision indicates, it is never the first choice for dealing with the problem of unreasonably high cable rates. All agree that the best way to keep rates reasonable, in a perfect world, would be a robust competitive market.' A regulatory regimen that seeks to emulate what a competitive market would produce, by comparison, is at best a poor substitute.

Nonetheless, just as with going to the dentist, it does no good to put off the need to address the problem, or pretend the visit isn't necessary. Denying the problem of excessive rates will not make it go away. Wishful thinking about competition will not hold rates to competitive levels. It is necessary to confront the issues and deal with them effectively.

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[1] In an Order under the same caption, 17 FCC Rcd. 15,974, released Aug. 14, 2002 *("Amending* ***Order"),*** the Commission revised paragraph 55 of the *NPRM&O*. Unless otherwise indicated, these Comments apply to the *NPRM&O* as amended.

From this perspective the salient fact about the Commission's current rate rules is this: they don't work. The rules are difficult and expensive to enforce. Even where they are enforced, they do not have the intended effect of holding rates to reasonable levels for consumers. It is true that in some cases – particularly with respect to equipment – rates have been restrained to some degree. But in many other cases the calculated FCC rate is actually higher than the monopoly market rate – a sure sign that the rules do not work as Congress intended.

These comments do not seek merely to complain about the problems with the current regulatory scheme. Rather, they seek to offer certain specific suggestions that could be used to improve the Commission's rules. At the same time, these comments do not purport to provide an exhaustive account of all the loopholes, missteps, confusions, and other failings that prevent the rules from doing their job. Instead, they attempt to target particular issues that have particularly bedeviled local franchising authorities and consumers. There are many more issues that could be addressed, if time and cost permitted.[3] It is strongly recommended that the Commission listen to consumer groups and other non-industry commenters to identify additional problems affecting the consumers Congress wrote the law to protect.[4]

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[2] *Cf.* 47 U.S.C. § 543(a)(2) (titled "Preference for competition")

[3] For example, the Commission's unwillingness to consider the enormous revenues cable operators earn from advertising, or the inconsistent accounting techniques used to avoid offsetting "launch fee" revenues from program providers, should be addressed if the Commission seeks a serious reform of its rate rules.

[4] *See, e.g.*, Chris Murray, Gene Kimmelman & Dr. Mark Cooper, Consumers Union, *Abusing Consumers and Impeding Competition: The State of the Cable Television Industry*, July 24, 2002, *available at* http://www.consumersunion.org/pdf/cable2002.pdf (last visited 10/21/02); Letter from Hon. John McCain, United States Senator, to Hon. Michael Powell,

B. Congress Intended the Rate Rules to Protect Consumers.

At this distance in time from the original establishment of the rate rules, it is useful to recall their purpose and intent

In 1992, Congress found that since rate deregulation in 1984, cable rates had increased at almost three times the rate of the Consumer Price Index – a net increase even when increased channel numbers were taken into account. Congress found that this increase was due to the market power wielded by cable operators, who generally possessed *de facto* monopolies.' Deregulation in 1984 had relied on the promise of competition to restrain rates. That promise had not been fulfilled. Congress recognized that, while competition for cable should be encouraged, it would be irresponsible to leave consumers at the mercy of cable operators' market power while "waiting for Godot" in the form of the anticipated era of full competition

Accordingly, Congress reinstituted cable rate regulation for basic and "cable programming service" ("CPS") tiers of service and related equipment.[6] Congress relied heavily on the Commission's expertise and careful oversight to achieve the goal of protecting

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Chairman, Federal Communications Commission (April 16, 2002), *available at* http://mccain.senate.gov/cablerates02.htm (last visited 10/21/02); and Letter from Hon. John McCain, United States Senator, to Hon. David M. Walker, Comptroller General, U.S. General Accounting Office (April 16, 2002), *available at* http://mccain.senate.gov/cablerates02.htm (last visited 10/21/02) ("*McCain GAO Letter*"); *In re Implementation of Section 11 of the Cable Television Consumer Protection and Competition Act of 1992*, CS Docket No. 98-82, Reply Comments of the Consumer Federation of America, Consumers Union, Center for Digital Democracy, and Media Access Project, *to* Further Notice of Proposed Rulemaking (Feb. 19, 2002).

[5] Cable Television Consumer Protection and Competition Act of 1992, Pub. L. No. 102-385, 106 Stat. 1460, § 2(a)(1)(2) (1992).

consumers from excessive prices. Placing all its rate-setting eggs in one basket, Congress set the Commission the task of making the rules that would govern both basic and (at that time) CPS rates. The Commission was instructed not merely to curb the more excessive practices of cable operators, but to ***ensure*** that basic rates ***were reasonable***

> (1) Commission obligation to subscribers
>
> The Commission shall, by regulation, ensure that the rates for the basic service tier are reasonable. Such regulations shall be designed to achieve the goal of protecting subscribers of any cable system that is not subject to effective competition from rates for the basic service tier that exceed the rates that would be charged for the basic service tier if such cable system were subject to effective competition.[7]

It is of the highest importance that Congress expressly placed the Commission under an ***"obligation to subscribers."*** The focus of rate regulation is on protecting subscribers, not cable operators. The Commission fails to obey this statutory mandate if it allows any unreasonable basic rates: the mandate is to ***ensure*** that rates are reasonable. And the standard for reasonableness is what *would* be charged if there were real competition facing incumbent cable operators

At the same time, Congress provided for local governments to conduct the actual business of regulating basic cable rates, pursuant to the Commission's rules.[8] Congress thus made local authorities ***co-regulators*** with the Commission in this endeavor. While the Commission was to have the final say in determining the meaning of its rules (read in light of the statutory goal of protecting subscribers), it was assumed that the FCC would work together

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[6] Regulation of the CPS tier was later terminated by the Telecommunications Act of 1996 ("1996 Act") as of March 31, 1999. ***See*** 47 U.S.C. § 543(c)(4).

[7] 47 U.S.C. § 543(b)(1)

with local communities in enforcing those rules and achieving that goal. Under the federal law, a local franchising authority appearing before the Commission on a rate appeal is not merely a litigant standing on equal terms with the protesting cable operator. Rather, the local community is coequal with the Commission, a partner in the same effort.

Nor did Congress intend the Commission merely to create rules and then walk away, leaving their enforcement to the unaided efforts of local communities. Rather, Congress took the trouble to issue specific instructions for the Commission to prevent cable operators from circumventing the rules

> Within 180 days after October 5, 1992, the Commission shall, by regulation, establish standards, guidelines, and procedures to prevent evasions, including evasions that result from retiering, of the requirements of this section and shall, thereafter, periodically review and revise such standards, guidelines, and procedures.’

Thus, this proceeding, instituted by the Commission in June of 2002, almost ten years after Congress issued the above mandate, is a step in the right direction. It is not clear whether one could identify any past regulations that responded specifically to this specific congressional call for action. But the Commission has now created an opportunity to cure some of the evasions that have so often vitiated the existing rules. If the Commission is to comply with the congressional mandate, it must take this opportunity to prevent evasions and improve the performance of its rules in preventing unreasonable rates – not to further weaken its rules or create new loopholes for evasion

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[8] See 47 U.S.C. § 543(b)(5)(A).

[9] 47 U.S.C. § 543(h).

II. THE COMMISSION'S RATE RULES HAVE FAILED TO PREVENT UNREASONABLE RATES.

This section speaks generally to the fact that the Commission's rules have failed to keep rates reasonable, and identifies a few of the reasons for that disappointing result. The recommendations that follow this critique seek to provide suggestions for some general ways in which the Commission could reform its rules to make them more effective in carrying out the mandate of Congress

A. Problem

1. Ten Years Later, Rates Are Still Unreasonable.

The simple fact is that cable rates are still unreasonably high and still reflect the market power enjoyed by almost all cable operators. This fact has been recognized in Congress:

> They [cable subscribers] continue to endure rate increases that outstrip, by many multitudes, the price increases of other consumer goods and services. . . . Why does there continue to be a 6.3% differential in monthly cable rates between competitive and noncompetitive cable operators?”

This congressional concern is well-founded. Since the passage of the 1996 Act, cable rates have risen on the average by 35.7 percent, while the Consumer Price Index has gone up only 14.5 percent.” The cable CPI increased 3.9% for the 12 months ending July 2001.[12] By

[10] *McCain GAO Letter* at 1.

[11] Brigitte Greenberg, *Cable Prices Rise More Than Other Goods and Services*, Communications Daily, Jan. 15, 2002, at 6.

[12] *2001 Competition Report* at ¶ 22, n.26. The Bureau of Labor and Statistics publishes a price index for cable services (“cable CPI”) as a sub-component of the overall consumer price index. The cable CPI includes equipment, all program services (including premium services) and installation costs, and is adjusted for improvements in quality. That is, the

contrast, in January 2002, cable operator announced among others the following specific and average rate increases:[13]

• AT&T Broadband	*5.5%*
• Time Warner Cable	*5%*
• Comcast	*5.5%* to 6.4%[14]
• Charter	*5%* to 10%
• cox	5.3%[15]
• Cablevision	5.5%[16]
• Mediacom	*5%* to *7%*
• Cable One	*5%*

These facts do not necessarily indicate that the Commission's rules have been wholly ineffective. It is plausible to conclude that certain cable rates are in fact lower than they would have been in the absence of any regulation at all. At the same time, however, it is clear that the rules have not achieved Congress' goal of ensuring reasonable rates – which is to say, those that would have obtained under real competition

It is often alleged that the presence of satellite video providers must be subjecting cable operators to competition." However, the plain fact is that the presence of **DBS,** encouraging

addition of channels is usually interpreted by BLS as an improvement in quality, so BLS will likely increase an observed price when channels are added.

[13] *Cable Prices Rise More Than Other Goods and Services* at 6

[14] Comcast did not release national averages, but acknowledges rate increases in Washington, DC and Baltimore, MD of *5.5%* and 6.4% respectively.

[15] New Orleans, LA and Santa Barbara, CA

[16] New York Metropolitan Area.

[17] *See, e.g., In re Annual Assessment of the Status of Competition in the Market for the Delivery of Video Programming,* CS Docket No. 01-129, Comments of the National Cable & Telecommunications Association to the Notice of Inquiry, at 9 (filed Aug. 2, 2001) (suggesting

though it is, has not been sufficient to bring about competitive rates. This is evidenced, among other things, by the fact that there is still a differential between rates where an operator faces real wireline competition from another cable company, and rates where it does not." If DBS competition were sufficient to ensure reasonable rates, there would be little if any difference – all areas would be equally competitive. In fact, that is not the case."

As noted above, under the instructions of Congress, the FCC's rate rules were to correct this problem. They have not. Indeed, the rate rules are sufficiently porous - provided with enough loopholes permitting cable operators to evade the requirement of reasonable rates – that in many locations around the country, the maximum permitted rate ("MPR") calculated under the Commission's rules actually exceeds the monopoly market rate charged by the cable operator. For example:

Community	MPR	OSR
Redondo Beach, CA	$35.06	$30.19
Ramsey/Washington Counties Suburban Cable Communications Commission, MN[20]	$11.80	$9.84

that the Commission declare effective competition in 40 states where statewide DBS penetration is claimed to exceed 15%).

[18] Where a cable system faces competition from DBS, there is no difference in rates as compared to noncompetitive systems. *Id.* at 10. On the other hand, where a system faces competition from another wireline cable provider or a LEC, the average monthly rate is $3.03 and $2.10 less than noncompetitive system rates.

[19] The Commission recently found: "Our price equation shows that the presence of a wireline overbuilder has a negative effect on cable rates. However, based on our limited data, the presence of effective competition due to DBS overbuild status has no significant effect on cable rates." *In the Matter of Implementation of Section 3 of the Cable Television Consumer Protection and Competition Act of* 1992, Report on Cable Industry Prices, 17 FCC Rcd. 6301, ¶ 45 (2002) ("2002 *Competition Report").*

[20] For nine of the ten cities served by this joint regulatory authority. In the other city, the MPR is $1 1.69 rather than $11.80; the OSR is still $9.84.

Community	MPR	OSR
North Suburban Communications Commission, MN	$10.61	$8.80
Quad Cities Cable Commission, MN	$9.43	$8.86
St. Louis, MO	$11.28	$10.74

2. The Commission's Rules Have Degraded Over Time.

In some cases what began as a well-intentioned rule has been eroded by exceptions, qualifications, or outright reversals of direction that rob it of its intended effect. This is not a universal trend: there have been cases where the Commission made an inadequate rule and later corrected it.[21] But all too often, the reverse has been true. For example, the Commission

[21] For example, the original Form 393 rate reduction was capped at ten percent; six months later, the Form 1200 calculation increased the potential reduction to seventeen percent. *See In re Implementation of Sections of the Cable Television Consumer Protection and Competition Act of 1992: Rate Regulation,* Report and Order and Further Notice of Proposed Rulemaking, 8 FCC Rcd. 5631, ¶ 14 & n.29 (1993) *("Rate Order");In re Implementation of Sections of the Cable Television Consumer Protection and Competition Act of* 1992: *Rate Regulation,* Second Order on Reconsideration, Fourth Report and Order, and Fifth Notice of Proposed Rulemaking, 9 FCC Rcd. 4119, ¶ 19 (1994) *("Second Reconsideration Order"); Overview of Revised Cable Benchmark Regulations*, March 30, 1994, at 1-2 (on file with NATOA). Similarly, the Commission originally sought to create a nationwide rule to deal with

originally reached a reasonable conclusion that a special pass-through was not necessary to encourage cable operators to upgrade their networks; the increased revenue from the improved facilities would provide that encouragement in a market-based fashion." Later, however, the Commission retreated from this position and allowed a special pass-through filing for network upgrades.[23]

The same result flowed from the Commission's "social contracts," in which cable operators were allowed to command permanent increases over the FCC-calculated maximum permitted rates in exchange for benefits which by their terms had only a limited life at best. For example, in a set of municipalities in St. Louis County, Missouri, the 1995 Commission deal with Continental Cablevision required a "lifeline basic" tier at a rate then set at $6.50.[24]

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documents claimed to be confidential; then, recognizing that communities in different states were unavoidably governed by different state laws, revised the rule to take account of state law. *See* Rate Order at ¶ 89 & n.349; this approach was revised in *In re Implementation of Sections of the Cable Television Consumer Protection and Competition Act of 1992: Rate Regulation – Buy-Through Prohibition,* Third Order on Reconsideration, 9 FCC Rcd. 4316, ¶ 79 (1994) *("Third Reconsideration Order").*

[22] *See, e.g.*, Rate Order at ¶ 256 & n.608; *In re Implementation of Sections of the Cable Television Consumer Protection and Competition Act of 1992: Rate Regulation,* First Order on Reconsideration, Second Report and Order, and Third Notice of Proposed Rulemaking, 9 FCC Rcd. 1164, ¶ 97 (1993) *("First Reconsideration Order").*

[23] *In re Implementation of Sections of the Cable Television Consumer Protection and Competition Act of 1992: Rate Regulation and Adoption of a Uniform Accounting System for Provision of Regulated Cable Service,* Report and Order and Further Notice of Proposed Rulemaking, 9 FCC Rcd. 4527, ¶¶ 280-291 (1994) *("Cost of Service Order").* The *NPRM&O* asks for comment on this issue at ¶¶ 36-37. While it seems clear that such an upgrade pass-through is unnecessary, these comments do not address that issue in detail.

[24] *See In re Social Contract for Continental Cablevision,* Memorandum Opinion and Order, 11 FCC Rcd. 2788, ¶ 44 (1995) *("FCC-Continental Order");* attached "Social Contract for Continental Cablevision, Inc." at § III.B. For ease of comparison with the MPR calculated on the Commission's forms, rates will generally be stated herein exclusive of franchise fees, which are, however, part of the rate.

The region is now looking at a 2003 rate increase that eliminates the lifeline tier and charges $12.00 for basic.[25]

This process illustrates a frequent problem with the rules as they have developed. Not only does this "one step forward and two steps back" approach erode the effect of an originally sensible rule; in addition, the layering of a special correction or exception on top of the existing rule gives rise to an extraordinarily complicated structure. This makes rate regulation so difficult that the ordinary layperson is unable to comprehend it; creates complexities and ambiguities that unnecessarily generate fruitless lawyers' arguments; and often falls victim to the "law of unintended consequences" in which the rules produce unexpected and unwelcome results simply because no one fully understood the combined effect of the various "corrections."[26]

3. The Commission's Rules Make the Review Process Unnecessarily Time-Consuming and Expensive.

This progressive complication of the Commission's rules over time intensifies another problem. The Commission's regulatory scheme takes too long to apply and is too costly for many franchising authorities to engage in. Even from the beginning, the Commission's methodology proved daunting for smaller communities – those without staffs of financial

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[25] The Commission refused to make available to local franchising authorities the analyses that led to the Commission's acceptance of this deal with Continental. ***See*** *FCC-Continental* ***Order*** at ¶ 3 n.7. The Continental system in St. Louis County was bought in 1996 by TCI, operated by AT&T Broadband after the latter's acquisition of TCI, then transferred to Charter in 2001.

[26] ***See,*** *e.g.*, the channel movement rules discussed in detail in Section IV *infra.*

analysts." As the rules became more complicated, epicycles piled on epicycles, it quickly became evident that only a specialized expert could hope to determine "where the bodies were buried" in a cable operator's rate filing. The result has been that many small communities have been priced out of the rate regulation market.[28]

Since the congressional plan for rate regulation relies on local communities to implement the Commission's rules, this problem with the workability of the Commission's rules has had a substantive effect in reducing the effectiveness of basic rate regulation. Indeed, had Congress known how the Commission would implement its statutory directive, it might well have needed to consider the effect of the Unfunded Mandates Reform Act of 1995,[29] which forbids the federal government to commandeer local property or local decision-makers for federal purposes. The burden placed on local resources by the Commission's rules is particularly problematic given that those rules do not even achieve those federal purposes, as pointed out above.

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[27] It is a matter of considerable concern that the Commission, in complying with the mandate of the Regulatory Flexibility Act to evaluate the impact of its rules on small entities, has consistently ignored the impact on small *communities* and focused exclusively on the impact on small *cable operators*. In the *NPRM&O*, for example, the Commission notes once – at paragraph 62 – that the RFA's "small entities" include the "small governmental jurisdiction," and then proceeds to ignore small governmental jurisdictions entirely throughout its four-and-a-half-page impact analysis.

[28] For example, one local franchising authority had to spend over $26,000 in 2001 to complete a rate review – much of it in extracting the necessary supporting information from the cable operator and debating with the operator the proper application **of** the Commission's rules. Such costs may be trivial for major MSOs, but they are significant for local communities.

[29] Pub. L. No. 104-4, 109 Stat. 48, *codified* at 2 U.S.C. §§ 1501 *ff*. (1995)

4. The Commission Has Failed to Make Rules or Take Other Steps to Prevent Evasions.

Perhaps the most damaging failure in the ten-year history of Commission rate regulation has been the apparent absence of any attempt to comply with the congressional mandate to prevent evasions. Not only has the Commission taken no discernible steps to stop evasions: on the contrary, in many cases the Commission has taken steps that positively encouraged evasions.

A recent example may be found in the *NPRM&O* itself (and is discussed in more detail in Section IV below). The cable industry's attempt to move channels out of the basic tier *while continuing to charge basic subscribers for a portion of their costs* can most charitably be described as a dogged attempt to take advantage of an alleged technical error by the Commission in drafting a "sunset" provision. The position taken in at least some industry filings makes no substantive sense and cannot have been adopted in good faith. The Commission responded *to* this problem by issuing a "clarification" in paragraph 55 (the "Order" part) of the *NPRM&O*. The clarification appeared to make clear that a cable operator could *not* continue charging for an absent channel. Yet the Commission then spontaneously issued a revision to its clarification, two months later, whose purpose (to the extent it can be discerned from the somewhat confusing text) appears to be to allow cable operators to "get away with" such charges in some cases.[30] The message this sends to cable operators is: If you can think of a clever way to defeat our rules, we'll let you have it. The effect of this message over the last ten years has not been salubrious.

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[30] *Amending Order* at ¶ *2*.

The classic example of rewarding evasions dates back to the "a la carte tier" controversy of 1994. When the initial rate rules were introduced, they exempted single-channel "à la carte" offerings. Some cable operators then created special tiers whose individual channels were ostensibly available a la carte, but priced the individual channels at so high a level compared to the entire tier that it would have been ludicrous for anyone to purchase the channels separately (and in fact, almost no one did so). Because the channels were theoretically available a la carte, the operators claimed that such tiers were unregulated. (Moreover, because of the way channels were counted in the benchmark formulae, excluding these channels from regulation *also* increased the MPR for the *other* tiers.)

In the face of this patently evasive tactic, the Commission took a remarkable step. In a series of orders issued on November 18, 1994, the Commission found that the "à la carte tiers'' avoided the application of rate regulation, and moreover that "there appears to he no sufficient justification for [the operator's] restructuring other than to avoid rate regulation."[31] In other words, this was not a good-faith attempt to apply the Commission's rules: it was a tactic with *no other justification* than evasion, Yet, the Commission did not sanction the operators for the evasive tactics. Astonishingly, the Commission did not even reverse the evasion itself and apply its rules as they had been intended to apply. Instead, on the grounds that the operators *might conceivably have believed* that their tactic was permissible under the

[31] *In the Matter of Comcast Cablevision City of Tallahassee, Florida, Letter of Inquiry,* Memorandum Opinion and Order, 9 FCC Rcd. 7773, ¶ 15 (1994). The full Commission affirmed this approach. *See In re Comcast Cablevision City of Tallahassee, Florida, Letter of Inquiry, Application for Review,* Memorandum Opinion and Order, 11 FCC Rcd. 1246 (1995)

rules, the Commission *approved* the tactic and allowed the ersatz a la carte tiers to remain unregulated.[32]

Thus, rather than applying its rules so as to ensure subscribers reasonable rates, as Congress demanded, the Commission applied a wholly inappropriate standard of intent, as if the correction of a rate to reasonable levels were a penal judgment against the operator. The net effect was that those operators who had tried the evasion actually gained ground over those who had not. The ersatz a la carte tiers were exempted from regulation without having to meet the standards applied for similar tiers later proposed by other operators. The clear message taken by the industry was: Unless an operator's filing was actually marked "THIS IS **AN** EVASION" in large block letters, the Commission would take for granted that any noncompliance was an honest mistake, even in the teeth of contrary evidence -- and, instead of correcting the mistake, *perpetuate* it. **A** more striking way of rewarding evasions could hardly be imagined.

Such examples could be multiplied."[33] But two points are worthy of special note. Both bear on the fact the Commission has failed to take any steps that would, as a practical matter, require cable operators to comply with local rate orders

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[32] In most cases. The Bureau applied a cutoff at six channels: a pseudo-tier with six or fewer channels was "canonized" as a "new product tier"; a pseudo-tier with seven or more was not approved. *See, e.g., In the Matter of: Adelphia Cable Partners, L.P.. South Dade County, Florida, Letter of* Inquiry, Memorandum Opinion and Order, 9 FCC Rcd. 7781 (1994) (rejected justification where 32 channels were placed on an "a la carte" tier, although operator was not sanctioned for the attempted evasion).

[33] To mention only two: the Commission early adopted the practice of allowing cable operators to keep relatively small subscriber overcharges on the grounds that the total overcharge per subscriber was *de minimis. See, e.g., In re King Video Cable Company Valley Springs. California, Benchmark Filing to Support Cable Programming Service Price,*

When a local franchising authority issues a rate order, that order is binding law unless and until it is either stayed or reversed by the Commission.[34] Allowing cable operators routinely *to* ignore rate orders that have been appealed but not stayed – as they have done throughout the history of rate regulation[35] – is tantamount to allowing evasions on a massive scale. Yet it was five years after 1993 before the Commission made any ruling that addressed cable operators' obligation to comply.[36] And the Commission has never taken any systematic

Memorandum Opinion and Order, 10 FCC Rcd. 1707, ¶ 8 (1995); *In re King Video Cable Company Jackson, California,* Memorandum Opinion and Order, 10 FCC Rcd. 1706, ¶ 8 (1995). Nothing in the statute authorizes the Commission to approve unreasonable rates on such grounds. More disturbingly, after the passage of the 1996 Act, the Commission applied that Act's deregulatory standards *retroactively* to complaints filed *before* the 1996 Act, on the remarkable grounds that it would serve no purpose to adjudicate these complaints because the later deregulation would automatically allow the cable operator to recapture the overcharge through a later rate increase – a rationale inconsistent with the notion that competitive pressures would limit arbitrary CPS tier rate increases. *See, e.g., In re Prestige Cable TV, Order Dismissing Rate Complaints,* Order, 12 FCC Rcd. 21,103, ¶ 4 (1997).

[34] ***See,*** *e.g.*, 47 C.F.R. §§ 76.922, 76.923, and 76.937(a); *In re Implementation of Sections of the Cable Television Consumer Protection and Competition Act of 1992: Rate Regulation,* MM Docket No. 92-266, Thirteenth Order on Reconsideration, 11 FCC Rcd 388, ¶ 24 (1995) *("Thirteenth Reconsideration Order")* ("a cable operator. . . may not increase its BST rates without approval from the franchising authority"); "An operator's appeal of an LFA's rate order does not stay that order. . . The Commission's rules are unequivocal: 'Operators may implement rate changes proposed in their filing 90 days after they file *unless the franchising authority rejects the proposed rate.*"' *In re TCI of Richardson, Inc., Appeals of Local Rate Orders Issued by the City of Richardson, Texas,* Memorandum Opinion and Order, 12 FCC Rcd. 21,690, ¶¶ 41-42 (1998) *("Richardson Order"), quoting Thirteenth Reconsideration Order* at ¶ 9 (emphasis added), *modified in other respects, In re TCI of Richardson, Inc., Petition for Reconsideration of Bureau Order Resolving Local Rate Appeals,* Memorandum Opinion and Order on Reconsideration, 14 FCC Rcd. 11,700, ¶ 33 (1999) *("Richardson Reconsideration Order").*

[35] *E g., In re Falcon Cablevision,* 12 FCC Rcd. 8229 (1997); *In re TCI Cablevision of Oregon, Inc.,* 12 FCC Rcd. 8216 (1997).

[36] *Richardson Order* at ¶¶ 40-42

steps to make sure that the industry is in fact complying with the basic principle that decisions of franchising authorities, the FCC's co-regulators, *must be obeyed* until stayed or reversed.

The second point is related. The Commission made a number of rules requiring operators to produce information, adhere to deadlines, and the like. But it failed to include rules that would provide simple, nationwide *enforcement* tools localities could use to make sure those rules were obeyed. When there is no penalty or other sanction for failure to comply, there is no obvious incentive for compliance. And there is no guarantee that local communities have the tools for such enforcement already in place. The Commission appears to have assumed that communities already had the power to impose fines or forfeitures for violations of the Commission's rules and the communities' rulings.[37] But that is not generally the case. In 1993 most franchise agreements of course predated the new rate rules, and few included specific enforcement mechanisms. Nor did the Commission itself ever take serious steps to enforce its own rules by sanctions that would provide a serious incentive for compliance.[38]

B. Recommendations

The following steps are suggested as ways to help address the problems mentioned above

[37] *See, e.g., Third Reconsideration Order* at ¶¶ 1, 80.

[38] For example, in one decision during the period of CPS tier regulation, where an operator failed outright to file the forms necessary for an increase under the Commission's rules, FCC merely extended the refund liability until the operator implemented the new rate order. *In re TCI Cablevision of Georgia, Complaint Regarding Cable Programming Services Tier Rate Increases*, Order, 12 FCC Rcd. 23,198, ¶ 8 (1997). Under such circumstances, an operator had nothing to lose by trying to evade the rules; at worst, it would merely have to make the refunds it would otherwise have had to make, and there was always the possibility it might get away with the evasion unnoticed.

1. Clearly Affirm Operators' Obligation to Comply With Local Rate Orders

The Commission should clearly restate and reaffirm the principle that a cable operator must comply with local rate orders unless and until those orders are stayed or reversed by the Commission, The operator must reduce its rates as ordered; make refunds as required; and use the approved rates as its starting point for future rate filings, whether or not the operator. has appealed the order

There is no need to make new law here. This legal fact is evident and inherent in the rate regulation authority enacted in the Cable Act itself. But experience indicates that the cable industry needs to be told without any ambiguity or confusion that it is legally required to comply with such orders.

2. Establish Enforcement Mechanisms

First and foremost, the Commission should enforce its own rules, rather than bending them to overlook cable operators' evasions. But in addition, the Commission should establish straightforward fines or forfeitures that localities can use to enforce the Commission's rate rules, address operators' refusal to produce required information, and deal with refusals to comply with local rate orders. In particular, where operators fail to respond to information requests or comply with rate orders, additional fines should be imposed for each day's delay. These measures could be separately established by regulation, or by delegation of Commission authority under 47 C.F.R. § 1.80. Such a nationwide method would immeasurably simplify the fundamental matter of making the existing rules work. It would also satisfy the cable industry's oft-stated preference for uniform national approaches. The amounts involved should be sufficient to give cable operators a substantial incentive to comply. (This means that at a minimum, they must outweigh the benefits operators would realize from refusing to comply.)[39]

Such enforcement rules could appropriately be utilized by local franchising authorities, the Commission's co-regulators. Any such sanctions could be made appealable to the Commission, so that the Commission could correct any mistakes in application at once. Under the same principle of compliance with local orders referred to above, however, fines or forfeitures should be paid by operators at once, without waiting for an appeal to be resolved -- to be returned if the sanction is ultimately reversed.

3. Make Available Actual Competitive Rates As Alternative Measures of Reasonable Rates

One of the most disturbing anomalies in rate-setting occurs when there is actual competition from a second cable operator in part, but not all, of an incumbent operator's service area. The result is frequently that in the competitive area rates go down, and special promotional offers reduce effective rates even further. Meanwhile, rates in the nearby *non*-competitive area remain significantly higher, and the same promotional terms are not made available.[40]

To be sure, this sort of contrast vividly illustrates the benefits of real competition. But it also demonstrates the burden of unreasonable (supracompetitive) rates placed on the

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[39] While some cable operators may comply voluntarily with local orders and requests, experience indicates there are enough "bad actors" to make sanctions necessary.

[40] For example, in Lebanon, Ohio, a municipal system began operating three years ago. Time Warner increased content and lowered prices. It refused specific requests from neighboring communities, lacking the municipal competitor, to extend the same changes to

subscribers not fortunate enough to live in the competitive area. If residents in one block, where two operators compete, pay (for example) $8.00 for service, while in the next block, beyond the overbuilder's range, residents pay $10.00 for the same service, there is perhaps the clearest evidence possible that the less-favored residents are overpaying by $2.00 due to the incumbent's market power.[41]

The Commission should adjust its rules to allow this evidence to be used in setting rates. The entire complex edifice of the benchmark scheme is, of course, merely an attempt to replicate what a competitive rate *would* be in the absence of actual competition. Referring to a nearby area in which there *is* actual competition is a much faster and more direct way to arrive at the same result. Thus, the use of actual competitive rates as a standard for nearby non-competitive rates would carry out the purpose of the benchmark method while streamlining the

those communities. Similar situations have occurred within a single jurisdiction where an overbuilder has not yet extended **its** system throughout the jurisdiction.

[41] It should be kept in mind that two competing sources do not necessarily make for robust or vibrant competition. It is easy, for example, to have two competitors fall into a price maker-price taker relationship, in which rates still do not descend to fully competitive levels. *See* F. Scherer, *Industrial Market Structure and Economic Perjormance, 56* (2d 1980); Stigler, *Notes on the Theory of Duopoly,* 48 Pol. Econ. 521 (1940). But the nearby overbuild at least establishes that the true competitive rate can be no *more* than (in the hypothetical example) $8.00.

Rate disparities of this sort are sometimes referred to as acceptable on the grounds that adjusting rates to "meet competition" is a good thing. Certainly it is a good thing when alternative providers give up monopoly profits to compete as to price in the competitive area. What is not a good thing is that the incumbent monopolist can continue to charge a supracompetitive price outside the competitive area. (Indeed, the overcharges in the monopoly area may allow the larger incumbent to cross-subsidize unreasonably low – predatory – prices in the competitive area, in order to drive the competitor out of business.) The point here is: When the incumbent reduces rates to "meet competition," that necessarily establishes that the competitive rate can be no higher than this "meeting competition" rate.

mechanism.[42] The resulting savings in "overhead" costs would benefit franchising authorities, cable operators, and the Commission (in its appeal capacity) as well.

Implementing this approach would involve rule changes of the following sorts:

(1) If a cable operator charges a given per-channel rate in one area where it faces actual competition from a second wireline multichannel video provider, there is a rebuttable presumption that a franchising authority can set the same per-channel rate in another area where the operator does *not* face such actual competition. The operator can overcome this presumption by making a quantifiable and verifiable showing of cost differences between the two areas, using those cost differences to adjust the rate. The burden should be on the operator to show that such an adjustment is necessary and that its amount is fully supported by verifiable costs."

(2) To enable a franchising authority to determine what the relevant rates are, a cable operator should be required to produce within ten days of a request its rate card and channel lineup for any jurisdiction, or area within a jurisdiction, specified by the local franchising authority.

(3) To make this work effectively, the Commission would need to apply effective competition tests according to those areas where competition actually does and

[42] ***See*** *NPRM&O* at ¶¶ 7, **27-29, 42-43** ("recalibration of the 'competitive differential"').

[43] To prevent any potential collusion between the operators, the franchising authority should retain the option of using the Commission's traditional methodology instead, if that methodology actually yields a lower rate. There is ample precedent for such alternatives: for example, the option for a cable operator to use benchmark or cost-of-service methods.

> does not exist, rather than by entire franchise areas. For example, it might be necessary to compare two sections of the same franchise area if the area is only partially overbuilt – for example, if a second cable operator's build-out is not yet complete, or if a local community has authorized a partial overbuild as the only practical way to achieve even limited competition. There are independent reasons to make this change in the Commission's rules in any case.[44]

Using actual competitive rates as an indicator of competitive prices would have the virtues of simplicity as well as fairness in carrying out the congressional mandate to guard subscribers against supracompetitive rates.

It should be noted that this is not a cure-all for cases where the rate rules fail to deliver truly competitive rates. There may be many areas where such comparisons are not available. The suggested rule, however, does offer both simplicity and substantive improvement.

4. Proactively Investigate Evasions

No doubt the Commission would prefer not to expend resources on pursuing and preventing evasions. Local franchising authorities sympathize with that sentiment. Willing and cooperative compliance would be better for all concerned than an expensive enforcement

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[44] ***See*** Section VI below

Such an approach need not conflict with the judicial limitations on the Commission's application of the uniform rate rules of 47 U.S.C. § 543(d). *Time Warner Entertainment Co. v. FCC,* 56 F.3d 151, 190-92 (D.C. Cir. 1995). The Commission would not be requiring uniform rates across an "effective competition" region. Rather, it would be using the *unregulated* rates in the competitive area to set regulated rates in the competitive area. Rates in the area of real competition would remain unregulated.

campaign Yet the examples above make clear that evasions cannot he prevented (as the statute requires) simply by making rules and hoping that they will be obeyed.

The Commission needs to take affirmative steps to find out whether its rules are working. This could involve spot-checks to review randomly selected filings and confirm supporting data, as in an IRS audit. It might also involve working with franchising authorities to identify areas where evasions may he occurring and taking a closer look at practices that may be used to evade the effect of the Commission's rules. For example, local communities could report to the Commission where fines or forfeitures are being applied, and thus highlight violations of the Commission's rules. While such proactive steps may involve costs, the Commission was expressly provided with funding at the outset of rate regulation to cover its administrative expenses, including the expenses of rate regulation.[45] That funding should he employed to further the purposes of the statute – to benefit consumers (who, after all, are the ones who pay the regulatory fee under the Commission's pass-through rules where rate regulation is effective). This is one way in which the Commission can do so.

Most of all, where the Commission finds (as in the à la carte tier affair) that cable operators are taking actions or adopting positions for no apparent reason *except* to evade, the Commission must impose sanctions on those operators for abuse of the Commission's process. These sanctions must he *over and nbove* the rollback to a reasonable rate – which is no punishment at all, merely the restoration of an approximately competitive price and denial of the benefits of monopoly power. We are unaware of any instance in the ten-year history of

[45] 47 U.S.C. § 159(a); 47 C.F.R. § 1.1155; *In re Implementation of Section of the Cable Television Consumer Protection and Competition Acr of 1992: Rate Regulation.* Fourth

rate regulation in which the Commission applied any sort of sanction to a cable operator, no matter how uncooperative the attitude or how tlagrant the violation of Commission regulations. Unless this changes, operators will have no real incentive to comply.

5. Proactively Investigate Anticompetitive Practices

Regardless of what repairs can be made to the rate regulation process, real competition is still better than the simulated competitive pricing of rate regulation. Accordingly, the Commission should investigate certain obstacles to wireline competition, in the interest of making rate regulation obsolete. In this respect, the history of the last several years is significant. Overbuilders have reported a variety of tactics used by incumbents to fend off competition.[46] The Commission should launch a serious investigation of actions taken by

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Order on Reconsideration, 9 FCC Rcd. 5795, ¶¶ 9, 12, nn.28, 35 (1994) *("Fourth Reconsideration Order").*

[46] For example: In one community with a municipal overbuilder, the incumbent cable operator offered 200 channels, including sixteen premium channels, for $24.95 month, plus $200 to switch to the incumbent's cable service, an additional $200 to switch to the incumbent's Internet service, and forgiveness of any old debt owed to the incumbent or its predecessor. *See* Comments of Scottsboro (Alabama) Electric Power Board ("SEPB") in the *Notice of* Inquiry in CS Docket No. 01-129, at 5, Appendix B (Aug. 3, 2001) *("SEPB Comments").* In a surrounding community with no competition, the incumbent offered 150 channels for $77.90 – *i.e.,* 212% more than Scottsboro rates for 25% fewer channels. SEPB used the incumbent's SEC filings to estimate that the Scottsboro month rate was $0.87 less than the incumbent's national average monthly operating expense (which did not include the additional cost of the $200 bounties, amnesty program, and six door-to-door promotional campaigns), *Id* at 6. Notably, the incumbent's rate in Scottsboro is $6.71 less than the average national monthly rate (programming only) offered by competitive systems for 61 channels – *i.e.*, almost *25%* more than the average competitive monthly rate for 228% more channels. *See 2001 Competition Report* at 10, Table 4. Other competitive providers have also reported incumbents offering below national average rates above average channel packages, switching bounties of $200-$300, and old debt forgiveness. *In re Annual Assessment of the Status of Competition in the Market for Delivery of Video Programming,* CS Docket No. 01-129, Comments of Knology, Inc. to the Notice of Inquiry, 4-5 (filed late, Nov. 20, 2001) *In re Applications for Consent to the Transfer of Control of Licenses Comcast Corporation and*

incumbents to frustrate, delay, or halt competition – predatory pricing, disinformation campaigns, threats of litigation, attempts to buy out competitors, and the like.[47] The Commission should also look closely at incumbents' demands for "level playing field" terms in state laws that may afford incumbents pretexts to confuse, delay, and impede competition.[48]

AT&T Corporation, Transferors to AT&T Comcast Corporation, Transferee, MB Docket No. 02-70, RCN Telecom Services, Inc., Written *Ex Parte* Comments in Response to Comcast (filed Aug. 27, 2002); *In re Applications for Consent to the Transfer of Control of Licenses Comcast Corporation and AT&T Corporation, Transferors to AT&T Comcast Corporation, Transferee*, MB Docket No. 02-70, RCN Telecom Services, Inc., Written *Ex Parte* and Accompanying Declaration (filed Aug. 14, 2002).

[47] *See, e.g.*, Gaskins, *Dynamic Limit Pricing: Optimal Pricing Under Threat of Entry*, 3 J. Econ. Theory 306 (1971) (a dominant firm may set a price lower than the point at which marginal costs equals price to discourage entry of other providers, which may ultimately allow the dominant firm to sell at a higher price in the future).

[48] The Commission has shown great openness to allegations by the telecommunications industries that franchising authorities are impeding competition. *See, e.g.*, *Inquiry Concerning the Deployment of Advanced Telecommunications Capability to All Americans in a Reasonable and Timely Fashion, and Possible Steps to Accelerate Such Deployment Pursuant to Section 706 of the Telecommunications Act of* 1996, CC Docket No. 98-146, Third Report, 17 FCC Rcd. 2844 (2002); *Inquiry Concerning the Deployment of Advanced Telecommunications Capability to All Americans in a Reasonable and Timely Fashion, and Possible Steps to Accelerate Such Deployment Pursuant to Section 706 of the Telecommunications Act of* 1996, CC Docket No. 98-146, Notice of Inquiry, 15 FCC Rcd. 16,641 (2000); *In re Promotion of Competitive Networks in Local Telecommunications Markets*, Notice of Proposed Rulemaking and Notice of Inquiry in WT Docket No. 99-217 and Third Further Notice of Proposed Rulemaking in CC Docket No. 96-98, 14 FCC Rcd. 12673, ¶¶ 70-85 (1999). There seems to be no evidence that the Commission is equally open to the idea that the incumbents themselves – *who, unlike the communities, have every reason to oppose competition* – may be acting anticompetitively. If the Commission has the resources to intrude, in the interests of competition, in areas where by statute it has no jurisdiction – *see, e.g.*, Brief Amicus Curiae of the Federal Communications Commission, *TCG* v. *City of White Plains*, 305 F. 3d 67 (2d Cir. 2002) – then the Commission must certainly have resources to pursue potential anticompetitive practices in **an** area where it has a direct mandate from Congress to prevent evasions.

6. Provide Funding for Implementation

One way in which cable operators can evade the effects of rate regulation is to make the process so expensive that many local communities will be "priced out" of the regulatory market. For example, frivolous appeals based on patently frivolous theories – such as the view that an operator can continue to charge subscribers for a channel they do not receive – have no purpose but to intimidate and deter local franchising authorities from applying the Commission's rules as Congress intended.[49]

The Commission could ameliorate this problem by making it explicit that local communities can charge cable operators, over and above their franchise fees, for the cost of rate regulation.[50]

When foot-dragging and refusal to cooperate (for example, on information requests) turn the rate review process into a war of attrition, it is the deep pockets who benefit In this case – particularly in light of the degree of consolidation in the industry over the past ten years – those deep pockets belong to the regulated entities. Alternative means of funding that do not further burden already-strained local resources (which must cover everything from schools to police and fire protection) could help to equalize this David-and-Goliath situation.

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[49] ***See*** Section IV below.

[50] The Commission itself found that it needed new funding to pay for the costs of implementing Congress' directive to regulate rates. ***See*** *Fourth Reconsideration Order* at ¶ 9 ("The purpose of requiring cable systems to pay various regulatory fees to the Commission is to permit the Commission to recover the annual cost of its various regulatory activities "). Local governments are in no better position to assume additional financial burdens.

The above suggestions deal with some of the broad problems facing rate regulation in general. The following sections, by contrast, seek to focus on certain selected specific problems. In each case an identification of the problem is followed by suggestions as to how it might be solved.

III. THE COMMISSION'S RULES PRETEND THERE IS "EFFECTIVE COMPETITION" WHERE THERE IS NO REAL RATE RESTRAINT

A. Problem

The *NPRM&O* raises the question of how cable operators may best demonstrate the presence of effective competition – conditions that make rate regulation unnecessary because the market itself provides the necessary discipline to keep rates reasonable.[51] This issue does in fact mark a problem that has long dogged the Commission's current rules. 'Those rules create several types of loopholes through which an operator may make an apparent showing of effective competition, even though market forces are not really acting to keep rates reasonable.

1. Divided Franchise Areas

The most striking example is the case of a divided franchise area in which cable operators that were granted overlapping franchises have instead effectively divided the community between them. Each operator may hold a franchise for an entire city, for instance, yet each keeps religiously to its own territory and does not overbuild its colleague.[52] No

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[51] *NPRM&O* at ¶¶ 52-53

[52] *See, e.g.*, *In re Century Cable of Northern California, Inc.*, *Petition for Revocation of the Certification of the City of San Buenaventura, California to Regulate Basic Cable Service Rates,* Memorandum Opinion and Order, 14 FCC Rcd. 18,604 (1999), *affd on*

subscriber actually has a choice, and neither operator has an incentive to keep rates low so as to attract subscribers from a competitor. Yet in such cases the Commission has frequently declared effective competition, based on the notion that the operators *could* overbuild each other, if they ever chose to do so

The Commission has recognized from time to time that supposedly overlapping operators may in fact be bound to engage in no competition at all.[53] But the Commission has generally required an extraordinarily high standard of proof as to the unlikelihood of such competition, even after years of silent refusal to compete by the cable operators.[54] As a result,

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reconsideration, In re Century Cable of Northern California, Inc., Memorandum Opinion and Order, 14 FCC Rcd. 18,604 (1999). This reluctance to compete is an attitude of very long standing in the cable community. *See, e.g.*, *Paul Allen Becomes Overbuilding with $1.65 Billion in RCN*, Communications Daily, Oct. 5, 1999, at 4; Matt Stump, *Changing Times*, Cable World, Oct. 18, 1999, at SO.

[53] *See, e.g.*, *In re Telesat Cablevision, Inc.*, *Petition for Reconsideration of Orange County, Florida to Regulate Basic Cable Service Rates*, Memorandum Opinion and Order, 10 FCC Rcd. 2807, ¶ 7 (1995) (contract of sale including agreement not to provide service in an area shows affirmative decision to limit service area): *In re Cecilton CATV Inc., Petition for Reconsideration of Certification of Cecil County, Maryland to Regulate Basic Cable Service Rates*, Memorandum Opinion and Order, 10 FCC Rcd. 2937, ¶ 11 (1995) (loan agreement incorporating agreement not to overbuild shows affirmative decision to limit service area)

[54] *See, e.g.*, *In re Daniels Cablevision, Inc. D/B/A/ Pala Mesa Cablevision, D/B/A/ North County Cablevision, D/B/A/ Cable TV of Lake San Marcos, Application for Review of Order of the Cable Services Bureau Granting Petition for Revocation of the Certification of San Diego County to Regulate Basic Cable Service Rates,* Memorandum Opinion and Order, 12 FCC Rcd. 16,594, ¶ 8 (1997); *In re TKR Cable of Northern Kentucky, Petition for Revocation of Certijication of Unincorporated Boone County, Kentucky to Regulate Basic Cable Service Rates,* Memorandum Opinion and Order, 11 FCC Rcd. 9973, ¶ 20 (1996); *In re Valley Center Cable Systems, L.P.*, *Application for Review of Order of the Cable Services Bureau Granting Petition for Reconsideration of San Diego County to Regulate Basic Cable Service Rates,* Memorandum Opinion and Order, 10 FCC Rcd. 11,940, ¶ 11 (1995); *In re Apollo Communications Corporation, Petition for Reconsideration of Certification of the County of Bartholomew, Indiana to Regulate Basic Cable Service Rates,* Memorandum Opinion and Order, 10 FCC Rcd. 988, ¶¶ 4, 6 (1994); *In re C-TEC Cable Systems of Michigan, Inc.*, *Petition for Reconsideration of Certijication of Cascade Charter Township, MI to Regulate*

subscribers who have no real hope of competition are left unprotected from unreasonable rates, contrary to the statutory mandate. Only rarely has the Commission acknowledged that years of unbroken side-by-side monopoly conditions are likely to continue, barring evidence to the contrary."

2. DBS-Only "Competition"

A second loophole has been opened by the recent wave of industry filings claiming that DBS alone provides sufficient "effective competition" to justify abandoning rate regulation. The Commission has approved many such filings." Yet the notion that DBS "competition" alone suffices to keep rates reasonable flies in the face of the Commission's own finding that

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Basic Cable Service Rates, Memorandum Opinion and Order, 10 FCC Rcd. 2178, ¶¶ 4, 6 (1994); *In re TCI Cablevision of Georgia, Petition for Revocation of Certification of the Consolidated Government of Columbus, Georgia to Regulate Basic Cable Rates.* Memorandum Opinion and Order, 10 FCC Rcd. 597, ¶ 5 (1994), *quoting First Reconsideration Order* at ¶¶ 24 and 25; *In re American Cable Company, Petition for Reconsideration of the Certification of City of Columbus, Georgia to Regulate Basic Cable Rates*, Memorandum Opinion and Order, 9 FCC Rcd. 7212, ¶ 6 (1994).

[55] *See, San Buenaventura Order*

[56] *E.g., In re Charter Communications Entertainment I, L.L.C., d/b/a Charter Communications, Petition for Determination of Effective Competition in Sixteen Missouri Communities,* Memorandum Opinion and Order, **DA** 02-2946 (Nov. 1, 2002); *In re TWI Cable Inc., d/b/a/ Time Warner Cable Petition for Determination of Effective Competition in the City of Live Oak, Florida,* Memorandum Opinion and Order, **DA** 02-2488 (Oct. 4, 2002); *In re Marcus Cable Associates, d/b/a/ Charter Communications, Inc., Petition for Determination of Effective Competition in Denton, TX (TX0580)*, Memorandum Opinion and Order, **DA** 02-2174 (Sept. **6**, 2002); *In re Falcon Cable Systems Company II, a California Limited Partnership, d/b/a Charter Communications Petitions for Determination of Effective Competition in Twelve Oregon Cities,* Memorandum Opinion and Order, 17 FCC Rcd. 4648 (March 15, 2002); *In re Marcus Cable Associates, D/B/A/ Charter Communications, Petitions for Determination of Effective Competition in: Burleson, Texas; Keller, Texas; Mansfield, Texas; Edgecliff Village, Texas; Kennedale, Texas;* ***Blue*** *Mound; and North Richland Hills,* Memorandum Opinion and Order, 16 FCC Rcd. 14,435, ¶ *3* (2001); *In re Time Warner Entertainment –*

"the presence of effective competition due to DBS overbuild status has no significant effect on cable rates."[57] The fact is that DBS "competition" is not keeping rates down, no matter how much the cable industry may fear it. Thus, to depend on DBS is to abandon the Commission's responsibility under the law to protect subscribers from unreasonable rates.

It does not appear from the Commission's recent approvals that the Commission has made any independent study of this new form of "competition," nor undertaken any independent investigation of the cable operators' allegations, factual data, or methodologies. On the contrary, it appears that the Commission is accepting operators' statements essentially at face value and placing the burden on local franchising authorities to refute these claims. But this approach impermissibly shifts the burden of proof to the local community – the party least able to address the issue.

It is difficult for local communities to investigate the weaknesses in the industry's DBS filings, because they do not have access to the underlying data. Even if the franchising authorities subjected to "effective competition" filings were not constrained by the limited time – twenty days – available under the Commission's pleading schedules;[58] even if the cost of a detailed factual investigation were not prohibitive; the fact remains that the SkyTrends data on which cable operators rely are not available to local communities – only to cable operators. And when the operator can pick and choose which data to present, it is unlikely that franchising authorities with limited time and limited means will be able to locate any

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Advance/Newhouse Partnership D/B/A/ Time Warner Communications, 15 FCC Rcd. 8852 (2000); *Jones Intercable, Inc.*, 15 FCC Rcd. 1251 (2000).

[57] *2002 Competition Report* at ¶ 45. *See* n. 19 *supra* and accompanying text.

[58] *See* 47 C.F.R. § 76.7(d)

weaknesses, biases, or outright inaccuracies that may exist in the operators' carefully chosen data set.

For example, a September 3, 2002, filing by Charter for a number of small cities including Town and Country, Creve Coeur. and Ballwin, Missouri, used government census data for the number of municipal households, hut used SkyTrends data for the number of households per Zip code - a number that is also available from the census data. It is difficult to determine the impact of such inconsistencies. But there appear to he other, grosser errors. The city of Creve Coeur includes homes in two Zip codes, 63141 and 63146, but the filing appears to omit 63146 altogether. Town and Country includes three Zip codes, 63131, 63017, and 63011, two of which contain Charter corporate offices - hut only 63017 appears to have been used in the filing. The data also reports one DBS subscriber and 498 households in Zip code 63022, but that Zip code turns out to contain only post office boxes: the census data shows no houses there.[59] Clearly the reliability of the data presented in such a petition is open to question, and it should be the responsibility of the cable operator to show its accuracy.[60]

Even if a serious investigation by the Commission were to determine that the industry's estimates of DBS *penetration* were correct, there may well be other reasons why DBS fails to provide an effective competitive alternative. (Again, we know that it does fail, because the

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[59] The post office for that Zip code may be contacted at 636-227-5783.

[60] At the most basic level, there is no reason to think that the SkyTrends data must be wholly accurate, particularly when both the DBS systems providing the data (for the benefit of the financial markets) and the cable operators presenting the data (for purposes of their effective competition claims) have an interest in overstating subscribership. Such overstatements are not unheard of in other contexts. *See, e.g.*, Robert Frank and Deborah Soloman, *Adelphia Inflated Customer Base - Numbers Overstated **By** Up to 10%*, Wall Street

Commission and the GAO found "no significant effect" on rates from DBS "competition.") The Commission appears to have assumed in its original rules that DBS would provide programming "comparable" to cable based solely on offering more than twelve channels of service.[61] Yet the programming packages offered by DBS are not qualitatively identical to cable's basic tier, whose defining factor is the inclusion of broadcast and PEG channels. Until recently, **DBS** could not provide local broadcast channels; and even now, only certain areas nationwide receive some or all of the local channels available on the local cable system.[62] DBS subscribers do not receive local public, educational, or governmental access channels.[63] One

Journal, June 7, 2002, at A3. Unless and until the Commission conducts an independent investigation, there is no way to know.

[61] ***See,*** *e.g.*, Rate Order at ¶¶ 32, 38 & n.100. Under 47 U.S.C. § 543(*l*)(1)(B)(i), a potential competitor must offer "comparable video programming." The statute does nor define "comparable." Commission rules at 47 C.F.R. § 76.905(g) define "comparable" for this purpose as involving at least twelve channels of video programming, "including at least one channel of nonbroadcast service programming."

[62] Satellite Home Viewer Improvement Act of 1999, included as Title I of Appendix I of the Cosolidated Appropriation Act of 2000, Pub. L. No. 106-113, 113 Stat. 1501, 1501A-523 to 1501A-544 (1999).

The Commission had determined on an interim basis that local broadcast signals must be included if programming is to be "comparable" at least with respect to the fourth statutory criterion for effective competition. Later, however, the Commission reversed itself and determined in its final rule that comparable programming under all of the effective competition criterion should be defined as twelve channels including one channel of nonbroadcast service. *In re Implementation of Cable Act Reform Provisions of the Telecommunications Act of 1996,* Order and Notice of Proposed Rulemaking, 11 FCC Rcd. 5937, ¶ 12 (1996) and *In re Implementation of Cable Act Reform Provisions of the Telecommunications Act of 1996,* Report and Order, 14 FCC Rcd. 5296, ¶¶ 16-22 & nn.57-58 (1999) ("*Effective Competition Order").*

[63] The Commission seems to have dismissed this difference as insignificant. *In re Con Com, Inc. [New Orleans],* Memorandum Opinion and Order, 14 FCC Rcd. 7134, ¶ 19 (1999). Yet numerous local communities have considered such channels sufficiently important to count among their future cable-related needs and interests, and have devoted significant sums to their development.

plausible reason why DBS has not acted as a brake on cable rates is that viewers do not see the two as truly interchangeable products.[64]

3. Anticipation of Future Competition

A third abuse of the "effective competition" notion occurs when a cable operator relies on the potential for *future* competition as a way of escaping rate regulation *now.* It has been suggested that the mere threat of possible competition may suffice to keep cable rates in line.[65] It is at least equally likely, however, that the threat of possible competition may spark a wave of rate *increases,* as the incumbent operator seeks to extract all possible monopoly rents while it still can and to build up a cushion or "war chest" for its battle against competition.

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[64] Moreover, beyond the programming packages involved, the different characteristics of DBS and cable may give consumers pause in substituting one for the other. DBS involves the physical attachment of unfamiliar and bulky equipment (compared to a cable set-top box), in part on the outside of a residence. The equipment may or may not require significant up-front capital investment from the consumer, depending on the particular promotional packages involved. That investment may be particularly difficult for those on low or fixed incomes, many of whom are tenants likely to move more frequently than homeowners. The subscriber (particularly in MDUs, urban high-rise areas, heavily forested or wooded areas, and/or northern latitudes further from equator-orbiting DBS satellites) may lack line-of-sight to the satellite. The feed is normally limited to a single channel for all televisions in the house, unless additional receivers, specialized antennae, and additional service fees for additional receivers are purchased. Any or all of these points – which have been loudly publicized by the cable industry as reasons for choosing cable over satellite – may help to explain why subscribers do not necessarily see DBS as a ready substitute for cable.

[65] The Commission cited: "*Time Warner Entertainment-Advance/Newhouse Partnership and Paragon Communications* (North and South Pinellas Counties, FL), 12 FCC Rcd 3143 (Cab. Serv. Bur. 1997) (effective competition found where LEC competitor completed 15% of service area and its franchise require completion throughout franchise area within three years; incumbent cable operator has lost subscribers and planned programming upgrades); *Comcast Cablevision of the South*, 13 FCC Rcd 1676 (Cab. Serv. Bur. 1997) (effective competition found where franchises authorize LEC service through franchise areas, LEC competitors began by using facilities constructed for video dialtone service through parts